



**COUNTY OF LOS ANGELES  
DEPARTMENT OF AUDITOR-CONTROLLER**

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TO: Supervisor Michael D. Antonovich, Mayor  
Supervisor Gloria Molina  
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Supervisor Zev Yaroslavsky  
Supervisor Don Knabe

FROM:

Wendy L. Watanabe  
Auditor-Controller

SUBJECT: **REVIEW OF INTRAFUND TRANSFERS AND ITS EFFICIENCY AND  
EFFECTIVENESS – BOARD MARCH 22, 2011 MOTION**

On March 22, 2011, your Board directed the Auditor-Controller to review all departments that are funded primarily through Intrafund Transfers (IFT), determine whether this budgetary practice is still the most efficient and effective means for funding departments, and report back during budget deliberations.

**IFT Working Group**

Representatives from the Auditor-Controller, Chief Executive Office, Departments of Human Resources (DHR), Internal Services (ISD), and Public Social Services (DPSS) formed a Working Group and met on March 30 and April 21, 2011. We discussed various topics involving IFT, including background, benefits and disadvantages associated with central service billing, overall efficiencies and effectiveness, cost recoveries through federal and the State claiming process of qualified programs, County's annual Cost Allocation Plan (CAP) as required by the State, IFT's role in County's budgetary and accounting process, recent Countywide system development, and strategic initiatives.

**Background**

Currently, there are ten departments which primarily exist to provide central services to all other County departments. The following is a listing of these departments, along with their Fiscal Year (FY) 2009-10 total amount of expenditures, IFT, revenue, the net

County cost (NCC) and the percentage of NCC to total expenditures. The percentage of NCC represents the departments' reliance on billing either other County departments or billing other jurisdiction or public for their services. The NCC % ranges from 4% for ISD to 98% for Chief Information Office (CIO) with a County average of approximately 19%. Take ISD's low percentage of NCC as an example, it represents that almost its entire cost to operate the department is recoverable through the billing mechanism. Contrary to ISD, the CIO is almost entirely funded by NCC. In both cases, regardless of low or high percentage of NCC, it is the reflection of County's budgetary policy.

**COUNTY OF LOS ANGELES**  
**Fiscal Year 2009-10 NCC% to Expenditure by Central Service Departments**

	<b>Expenditure Amount</b>	<b>Intrafund Transfers (IFT)</b>	<b>Revenue</b>	<b>Net County Cost</b>	<b>NCC %</b>
Affirmative Action and Compliance	\$ 12,080,565	\$ (6,726,616)	\$ (2,430,356)	\$ 2,923,593	24%
Auditor-Controller	\$ 79,799,042	\$ (44,266,969)	\$ (19,248,733)	\$ 16,283,340	20%
Board of Supervisors	\$ 73,952,653	\$ (6,838,615)	\$ (10,370,994)	\$ 56,743,044	77%
Chief Executive Office	\$ 82,525,296	\$ (31,811,343)	\$ (16,085,662)	\$ 34,628,291	42%
Chief Information Office	\$ 4,657,021	\$ (76,677)	\$ (922)	\$ 4,579,422	98%
County Counsel	\$ 83,395,136	\$ (67,370,220)	\$ (11,407,945)	\$ 4,616,971	6%
Human Resources	\$ 42,101,008	\$ (26,267,003)	\$ (7,622,001)	\$ 8,212,004	20%
Internal Services	\$ 388,880,999	\$ (264,418,095)	\$ (107,630,507)	\$ 16,832,397	4%
Office of Public Safety *	\$ 100,874,235	\$ (42,812,933)	\$ (44,752,131)	\$ 13,309,171	13%
Treasurer & Tax Coll.	\$ 67,033,260	\$ (10,094,387)	\$ (36,389,619)	\$ 20,549,254	31%
	<u>\$ 935,299,215</u>	<u>\$ (500,682,858)</u>	<u>\$ (255,938,870)</u>	<u>\$ 178,677,487</u>	<u>19%</u>

\*In FY 2009-10, the Office of Public Safety was an independent department with its own budget unit. It was subsequently transferred into the Sheriff's Department in FY 2010-11.

To summarize, the County's ten central service departments recover over \$756 million (approximately 81%) of their cost through the billing process. The cost recovery process administered by the Auditor-Controller reconciles and examines the remaining \$179 million to ensure County's billing practices comply with federal laws. It further enables the County to receive full cost recovery associated with federal and State programs. We will address the cost recovery process later in this report.

In addition, the County maintains several budget units which are designed to centrally budget and pay for Countywide costs and later distribute such costs to each of the departments. Examples of these budget units include utilities, rent expense, and judgments and damages. Also, there are integration of services by County departments such as Department of Mental Health (DMH) providing services to the Departments of Probation (Probation) and Children and Family Services (DCFS). Probation and DCFS

pay DMH for its service but later submit their cost reimbursement claims to federal or State and the County did not incur new costs.

For purposes of this review, we did not examine the billing practices for these non-departmental units or integrated services.

#### General Fund Departments

County General Fund Departments budget, record and charge their services to each other by using a mechanism known as IFT. Generally, IFT is a form of revenue and it offsets expenditures. For example, central service department such as ISD provides for building maintenance and County Counsel provides for legal consultations to County Departments. Both the service-receiving and service-providing Departments record these services and costs. From a fiscal and accounting standpoint, this is an appropriate practice since it accurately tracks and captures associated operating expenses, as incurred by each Department or each program.

For service-providing Departments, the recording of IFT accurately reflects the time and material cost they incurred while servicing other Departments and, therefore, they should be "compensated" or receiving a "revenue" to offset their cost. Hence, IFT reduces the service-providing Departments' overall financing requirement and it reduces these Departments' NCC. Conversely, for the service-receiving Departments, the cost of such service is recorded as an expense, since they have essentially "purchased" and "paid" for the needed services.

#### Non General Fund Departments

For County Departments outside of General Fund, such as County Hospital Enterprise Funds, Road Funds, or Special District Funds, the service-providing Departments will recognize the fee received as revenue for time and material they incurred while servicing other Departments. The term of IFT is not applicable for non General Fund Departments but it serves exactly the same purpose as revenue. For the service-receiving Departments, the cost of such service is also recorded as an expense for the "purchasing" of needed services.

#### Budgetary Practices of Other Government Agencies

Based on our research, other governmental agencies, which are highly dependent upon federal and State revenues, also bill service-receiving departments for their consumption of services. Agencies with minimal or no dependence on intergovernmental revenues are less likely to engage in formal billing for services. We also learned that an alternative mechanism that is used at a few government agencies is the concept of an Internal Services Fund. This concept separates the central service department from the General Fund into a standalone Internal Services Fund. Since the

separate fund cannot operate at a deficit, it creates an accounting mandate to account for the full costs of providing the service and to fully recover those costs through charges to the service-receiving department.

As discussed later in this report, the County's current practice emphasizes revenue recovery and full cost accounting, while providing the discretion to centrally fund certain strategic services.

### **Benefits and Efficiencies/Effectiveness Associated with Central Service Billing**

There are considerable benefits associated with interdepartmental billing and the use of IFT. These benefits are listed below:

- It provides for accurate accounting of full operating costs within County programs and, ultimately, it provides for better tools in financial reporting and budgeting.
- The County's current billing practices facilitate reimbursement of subvention program costs and ensure the timeliest cash recovery possible. Federal and State revenues which fund many County programs provide the County with the opportunity to claim central services costs and overhead.
- The current process provides a thorough audit trail in the event of program or financial audits.

County social services departments such as DPSS, DCFS, and DMH heavily rely on federal and State revenues (e.g., CalWORKs, TANF, Title IV-E, Medi-Cal, etc.). Additionally, there are departments that receive large federal and State grants, such as Probation and the Sheriff's Department. All of them are required to track their costs and present billing documents to receive reimbursable grant dollars and they are subject to compliance and fiscal audit by federal and State auditors. We have seen disallowed grant dollars when grantee departments cannot provide billing or costs documentation, resulting in County repaying funds to the federal or State agencies.

Another example is in the "maintenance of effort" (MOE) area and there are significant intergovernmental revenues involved. Departments with MOE requirements such as Health Services and DMH must document total costs, including central service departments' costs, to demonstrate required MOE's are met. In some fiscal years, central service costs were a determining factor in complying with MOE requirements and have enabled the County to fully qualify for all available revenues.

One of Governor Brown's major budget proposals contains program realignment shifts, which potentially transfers a number of major State programs to Counties. In evaluating the adequacy of State revenues that would pay for such programs, it is important for the County to consider central services charges and costs. The County's current practice of billing such costs will aid in determining the reasonableness of the revenues which will fund these new programs.

The total costs of service include direct and indirect costs such as operating and maintenance costs, overhead, and charges for use of capital (depreciation and debt service). Your Board may choose not to recover all costs, but should nonetheless receive the information necessary to make an informed decision. State law, County ordinances, and Board policies are all factors, which govern the establishment of fees and charges.

### **Cost Recoveries through Federal and State Claiming Process and County's Annual Cost Allocation Plan (CAP) Submission to the State**

Approximately \$9 billion of the County's General Fund revenues are from federal and State assistance or charges for services. These revenue streams are generally associated with cost recovery and dependent upon accurate cost accounting systems or information. Accordingly, the County must satisfy significant cost allocation and documentation requirements imposed by federal or State guidelines in order to remain eligible for federal, State and other reimbursed revenues.

In order to ensure the County's billing practices comply with federal Office of Management and Budget requirements (commonly referred to as A-87), the Auditor-Controller submits an annual Cost Allocation Plan (CAP) for approval by the State Controller. The CAP reconciles and examines the final year-end cost of each central service in comparison with all cost recoveries (IFT and revenues). If the County did not bill (or overbilled) its recoverable costs from federal and State programs, the CAP provides a final mechanism to adjust reimbursement claims to match the County's actual financial results.

The County's CAP has been approved without any serious findings for the past 15 years and has contributed to the County's ongoing ability to remain eligible for significant federal and State grant funding. Therefore, it is crucial that the County continues to maintain reliable records within interdepartmental billing.

### **IFT's Role in County's Budgetary and Accounting Process**

IFT has been a tool to use in County budgeting and accounting for many years. In addition to properly track expenses, it plays an important role in the federal and State claiming process for cost reimbursement. The County's budgeting process generally places much emphasis on NCC. County departments responsible for delivering services to the public occasionally perceive that departments with relatively low NCC are less exposed to budget curtailments. Reductions in IFT funded services are not separately highlighted in the central service departments' budget the way NCC reductions are shown. A corresponding reduction (i.e., budget curtailment) in departments' Appropriation, such as Salary and Employee Benefits (S&EB), usually goes hand-in-hand with the IFT reduction.

For example, we confirmed that ISD eliminated 232 positions during the past two years and reduced their associated IFT (therefore no billings to departments). However, this type of reduction does not have NCC impact since the reduction in eliminating positions (S&EB) is offset by the reduction of IFT. Although many budget curtailments focus on NCC, the Chief Executive Office has imposed other curtailments, which are directed to all departments, such as mandatory overtime reduction and curtailed usage of 120-day retirees.

A common complaint of departments that receive central services is that they are not given adequate funding to pay for such services. As a result, they must cut deeper into commodities and services which are purchased from external vendors. This issue has often been categorized as a "billing issue" when in fact it is really a budget issue. It is essential that the service level, IFT and revenue assumptions in the central service departments match the service requests and funding in the departments which purchase services.

### **Recent Countywide System Development**

The County's IFT billing processes have become more efficient due to increased automation of departmental cost accounting records and the County's implementation of the enterprise-based financial accounting system - eCAPS. In addition, the County's shared services initiative developed in the Auditor-Controller handles these activities for 19 departments in a centralized, resources-sharing environment. There has also been a considerable investment in training staff Countywide on the various cost accounting and billing processes.

### **Strategic Initiatives**

In some cases, there may be a Countywide strategic or mission reason not to bill. This concept is supported by the Chief Executive Office and key providers of central services, such as ISD (information technology disaster recovery, data center services), Auditor-Controller (Countywide audit and investigative programs), and DHR (red team and central civil service exam process).

Centrally funding these services can potentially mitigate organizational or business risks for example by ensuring that all departments are able to take advantage of these functions without having to find additional funding and also by ensuring that the County does not pay to duplicate similar functions across departments. There have been occasions where departments have not used a central agency function or taken advantage of the expert knowledge in the central agencies, even though the departments might believe that is the best solution, but they are limited by budgetary considerations. Centrally funding some of these functions will enable all departments to take advantage of central agency expertise.

For example, the ability to perform critical building maintenance on an ongoing basis helps ensure that County-owned buildings and properties are preserved and costly repairs are avoided. When budget curtailments force departments to reduce funding for building maintenance, County facilities fall into disrepair and create higher deferred maintenance costs. Your Board has supported this in concept by providing NCC to the Extraordinary Maintenance budget unit of the General Fund. More recently, your Board has also supported NCC funding for Auditor-Controller's auditing services so that audits and investigations are pursued in areas without regard to the availability of departmental funds.

We believe that targeted use of NCC to fund strategic initiatives in central service departments is a worthwhile goal to pursue. Examples of such initiatives include investments in new technology and innovative approaches to County problems. The Chief Executive Office supports this concept and intends to recommend funding in the FY 2012-13 County Budget for such Countywide initiatives. We believe this approach, when used strategically, is compatible with continuing to bill client departments for ongoing core central services.

### **Conclusion**

In summary, the use of IFT is an accounting and fiscal tool and it is not the cause for budgetary limitations. It produces historical cost information, as a gauge, for departments to build their upcoming budget accordingly.

Additionally, there are minimal achievable savings associated with eliminating IFT billings. We believe that the County's current billing process maximizes the County's cash flow and revenue opportunities, minimizes unallowable costs from audits, and provides your Board and the public with the most informative data about the cost of specific departmental or programmatic operations. However, as indicated, there are also opportunities for strategic departmental initiatives, which merit consideration for NCC funding that is worth exploring in the upcoming fiscal years through Countywide budget initiatives.

Please call me if you have any questions, or your staff may contact John Naimo, Assistant Auditor-Controller at (213) 974-8484.

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